

DEPARTMENT OF STATE REVENUE
LETTER OF FINDINGS NUMBER: 98-0268
SALES AND USE TAX
FOR TAX PERIODS: 1994-1997

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Issues

1. Sales and Use Tax- Electronic Pre-Press Equipment

Authority: IC 6-2.5-3-2(a), P.L. 78-1989, IC 6-2.1-2-4, IC 6-2.5-5-3, Gross Income Tax Division v. National Bank and Trust Co., 79 N.E. 2nd 651, (Ind. 1948), Indiana Department of State Revenue v. Cave Stone, Inc., 457 N.E. 2nd 52 (Ind. 1983).

Taxpayer protests the assessment of tax on the electronic pre-press equipment.

2. Sales and Use Tax-Computer Management System

Authority: IC 6-2.5-5-3, 45 IAC 2.2-5-9 (j).

Taxpayer protests the assessment of tax on the computer management system.

3. Sales and Use Tax-Dumb Monitors

Authority: IC 6-2.5-5-3, 45 IAC 2.2-5-9 (j).

Taxpayer protests the assessment of tax on the dumb monitors.

Statement of Facts

Taxpayer is a commercial printer. Taxpayer prints brochures, catalogs, programs and various other color items for the sporting industry. Additional sales and use tax

was assessed after a routine audit. Taxpayer timely protested a portion of the assessment and a hearing was held. More facts will be provided as necessary.

1. Sales and Use Tax- Electronic Pre-Press Equipment

Discussion

In 1994 and 1997 Taxpayer purchased computers and software which were used exclusively in the pre-press area. These computers had film output, typesetting, and graphic capabilities. These computers and software programs are used daily in the production process and serve two purposes. Primarily, Taxpayer contends that they are the first step in the integrated manufacturing process. Taxpayer also produce pre-press work output which Taxpayer sells "as is".

Pursuant to IC 6-2.5-3-2 (a), Indiana imposes an excise tax on tangible personal property stored, used, or consumed in Indiana. A number of exemptions are available from use tax including those collectively referred to as the manufacturing exemptions. All exemptions must be strictly construed against the party claiming the exemption. *Gross Income Tax Division v. National Bank and Trust Co.*, 79 N.E. 2nd 651, (Ind. 1948). IC 6-2.5-5-3 provides for the exemption of "manufacturing machinery, tools and equipment which is to be directly used in the direct production, manufacture, fabrication of tangible personal property."

Taxpayer contends that the computers and software which it purchased in 1994 and 1997 qualify for this exemption which requires that qualifying property be directly used in the direct production process. Exemption is only granted to machinery that is used in a production process, the process of manufacturing tangible personal property. Therefore the first issue to be determined is whether the commercial printing process is a process which produces tangible personal property. The 1989 General Assembly enacted a series of amendments in P.L. 78-1989 which dealt with the characterization of commercial printing.

P.L. 78-1989 first amended IC 6-2.1-2-4 to read as follows:

The receipt of gross income from the following is subject to the rate of tax prescribed in Section 3 (a) of this chapter:

...

(7) The business of commercial printing that results in printed materials, excluding the business of photocopying.

From this initial provision in the gross income tax, amendments were then made to other gross income tax, adjusted gross income tax and sales/use tax provisions, cross referencing back to commercial printing as described in IC 6-2.1-2-4. Significantly, P.L. 78-1989 amended IC 6-2.5-5-3 adding the language underscored below that expressly references and incorporates the description of "commercial printing" set forth in IC 6-2.1-2-4.

(a) For purposes of this section:

...
(2) Commercial printing as described in IC 6-2.1-2-4 shall be treated as the production and manufacture of tangible property.

Since the above cited statute defines commercial printing as a manufacturing process, the computers and software will qualify for exemption if they are directly used in this direct production process. In Indiana Department of State Revenue v. Cave Stone, Inc., 457 N.E. 2nd 52 (Ind. 1983) the Court sets forth the test for determining whether a particular item qualifies for the directly used in direct production exemption from use tax. The Court stated that items which are considered essential and integral to the production process meet the requirements of the directly used in direct production language of the statute.

The computers and software in this situation are essential and integral to the production of Taxpayer's brochures, catalogs, programs, and other items for the sporting industry. Therefore they qualify for the directly used in direct production exemption.

Finding

Taxpayer's first point of protest is sustained.

2. Sales and Use Tax- Computer Management System

Discussion

In 1997 Taxpayer also purchased a computer management system. This was a sophisticated real time integrated software management and manufacturing system. The system handled administrative functions. Some of the administrative functions included job costing, accounts receivable, order entry, production reporting, general ledger, payroll, job loading, scheduling, and finished goods inventory. Taxpayer contends that the computer and software system were directly used in the direct production of its product and qualify for the manufacturing exemption from the use tax pursuant to IC 6-2.5-5-3. This system is not used, however, to actually effect a change in the article under production in the manufacturing process. The computer management system is used for managerial and nonoperational activities. Pursuant to 45 IAC 2.2-5-9 (j), this use of equipment does not qualify for the directly used in direct production exemption.

Finding

Taxpayer's second point of protest is denied.

3. Sales and Use Tax- Dumb Monitors

Discussion

Taxpayer also protests the assessment of use tax on Dumb Monitors. Taxpayer contends that these monitors qualify for the directly used in direct production exemption pursuant to IC 6-2.5-5-3. Dumb monitors are devices which are necessary to implement the printer's management system which was purchased in 1997. They pass information needed for the administrative functioning of the software system. Since they deal with administrative functions, these dumb monitors do not qualify for exemption from the use tax pursuant to 45 IAC 2.2-5-9 (j).

Finding

Taxpayer's protest is denied.